HEATING UP & COOLING DOWN - RECENT DEVELOPMENTS ON THE FLARING FRONT IN NORTH DAKOTA AND BEYOND

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I. Flaring – Why is it a “Big Deal”?
II. North Dakota Class Actions
III. North Dakota Regulatory Proceedings
IV. Remaining Challenges
V. Questions?
I. FLARING – WHY IS IT A “BIG DEAL”?

Why is gas flared?

» Because oil and gas companies don’t care about the environment
  • Flaring releases CO₂, but it is much more environmentally friendly than venting, which releases VOCs and GHGs.

» Because oil and gas companies only care about oil, particularly when prices are high
  • Oil and gas companies have no motivation to burn the gas; they want to sell it, but typically cannot economically do so.

» Because there is inadequate infrastructure

How much gas is flared?

» Less than 1% nationwide & less than 3% worldwide

» In North Dakota, however, approximately one-third of all the gas produced has been flared (high point was 36% in September 2011)

» Flaring is not limited to the Williston Basin

*For example*, in the first seven months of 2014, 20 bcf was flared in the Eagle Ford (exceeded amount flared in 2012 and on pace to surpass the amount in 2013)
I. FLARING – WHY IS IT A “BIG DEAL”?

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Who are the stakeholders?

» Industry
» Landowners
» Mineral Owners
» Environmental Groups
» Government/Regulators

I. FLARING – WHY IS IT A “BIG DEAL”?

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<table>
<thead>
<tr>
<th>North Dakota</th>
<th>January 2010</th>
<th>November 2014</th>
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</thead>
<tbody>
<tr>
<td>Oil Production (bbl/d)</td>
<td>235,000</td>
<td>1,187,000</td>
</tr>
<tr>
<td>Number of Wells</td>
<td>4,400</td>
<td>11,500</td>
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<tr>
<td>Average Production per Well</td>
<td>54</td>
<td>103</td>
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I. FLARING – WHY IS IT A “BIG DEAL”?

North Dakota 2008 2009 2010 2011 2012 2013 2014*

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<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014*</th>
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<tbody>
<tr>
<td><strong>Gas Production (mcf/yr)</strong></td>
<td>87,190,520</td>
<td>91,704,441</td>
<td>114,389,090</td>
<td>155,931,615</td>
<td>258,524,615</td>
<td>347,587,869</td>
<td>414,917,594</td>
</tr>
<tr>
<td><strong>Flared Gas (mcf/yr)</strong></td>
<td>26,839,443</td>
<td>23,829,153</td>
<td>30,975,630</td>
<td>53,773,560</td>
<td>83,587,511</td>
<td>106,647,736</td>
<td>118,911,139</td>
</tr>
<tr>
<td><strong>%</strong></td>
<td>31%</td>
<td>26%</td>
<td>27%</td>
<td>34%</td>
<td>32%</td>
<td>31%</td>
<td>29%</td>
</tr>
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* Does not include data for December 2014.

II. NORTH DAKOTA CLASS ACTIONS

» October 2013: mineral interest owners file 10 putative class actions in state court

» January 2014: mineral interest owners file 4 more putative class actions in state court

» 13 of 14 defendants removed the cases to federal court
II. NORTH DAKOTA CLASS ACTIONS

» The Control of Oil and Gas Resources Act

N.D.C.C. § 38-08-01, et seq.

- “It is hereby declared to be in the public interest to foster, to encourage, and to promote the development, production, and utilization of natural resources of oil and gas in the state in such a manner as will prevent waste; to authorize and to provide for the operation and development of oil and gas properties in such a manner that a greater ultimate recovery of oil and gas be had and that the correlative rights of all owners be fully protected; and to encourage and to authorize cycling, recycling, pressure maintenance, and secondary recovery operations in order that the greatest possible economic recovery of oil and gas be obtained within the state to the end that the landowners, the royalty owners, the producers, and the general public realize and enjoy the greatest possible good from these vital natural resources.” (N.D.C.C. § 38-08-01)

» The North Dakota Industrial Commission (“NDIC”)

- Part of the Oil and Gas Division of the Department of Mineral Resources
- NDIC “has continuing jurisdiction and authority over all persons and property, public and private, necessary to enforce effectively the provisions” of the Oil and Gas Act. (N.D.C.C. § 38-08-04)
The North Dakota “Flaring Statute,”
N.D.C.C. §38-08-06.4, provides:

1. As permitted under rules of the industrial commission, gas produced with crude oil from an oil well may be flared during a one-year period from the date of first production from the well.
II. NORTH DAKOTA CLASS ACTIONS

The North Dakota “Flaring Statute”:

2. After the time period in subsection 1, flaring of gas from the well must cease and the well must be:
   a. Capped;
   b. Connected to a gas gathering line;
   c. Equipped with an electrical generator that consumes at least seventy-five percent of the gas from the well;
   d. Equipped with a system that intakes at least seventy-five percent of the gas and natural gas liquids volume from the well for beneficial consumption by means of compression to liquid for use as fuel, transport to a processing facility, production of petrochemicals or fertilizer, conversion to liquid fuels, separating and collecting over fifty percent of the propane and heavier hydrocarbons; or
   e. Equipped with other value-added processes as approved by the industrial commission which reduce the volume or intensity of the flare by more than sixty percent.
The North Dakota “Flaring Statute”:

4. For a well operated in violation of this section, the producer shall pay royalties to royalty owners upon the value of the flared gas and shall also pay gross production tax on the flared gas at the rate imposed under section 57-51-02.2.

5. The industrial commission may enforce this section and, for each well operator found to be in violation of this section, may determine the value of flared gas for purposes of payment of royalties under this section and its determination is final.
II. NORTH DAKOTA CLASS ACTIONS

The North Dakota “Flaring Statute”:

6. A producer may obtain an exemption from this section from the industrial commission upon application that shows to the satisfaction of the industrial commission that connection of the well to a natural gas gathering line is economically infeasible at the time of the application or in the foreseeable future or that a market for the gas is not available and that equipping the well with an electrical generator to produce electricity from gas or employing a collection system described in subdivision d of subsection 2 is economically infeasible.
II. NORTH DAKOTA CLASS ACTIONS

» **Plaintiffs’ Claims:** royalties on the value of the flared gas

- **Count I:** alleged violation of the Flaring Statute and certain NDIC orders pertaining to particular wells at issue in each case
- **Count II:** sought declaratory relief for royalties on all past and future flared gas based on alleged violation of the Flaring Statute
- **Count III:** asserted a claim for conversion of unpaid royalties attributable to the flared gas
- **Count IV:** alleged the producers committed common law waste by flaring the gas
- **Count V:** asserted claim under the North Dakota Environmental Law Enforcement Act of 1975, N.D.C.C. § 32-40-01 et seq. ("ELEA"), which provides a private right of action for violation of environmental statutes, rules, or regulations
II. NORTH DAKOTA CLASS ACTIONS

» Defendants’ Initial Defenses: motions to dismiss

• Defenses pertaining to the specific facts and circumstances concerning production and flaring from the wells in which the particular named plaintiffs had an interest

• Plaintiffs failed to exhaust their administrative remedies before the NDIC

• Plaintiffs did not have an express or implied private right of action for royalties under the Flaring Statute

• The ELEA did not allow plaintiffs to circumvent the comprehensive regulatory framework of the Oil and Gas Act or its available administrative remedies

• Plaintiffs' conversion and waste claims had to be dismissed because statutes preempt common law claims
II. NORTH DAKOTA CLASS ACTIONS

» **The Federal Court’s Order:**
  • Plaintiffs failed to exhaust administrative remedies before the NDIC
  • No express or implied private right of action
  • ELEA did not apply (at least not yet)
    • Plaintiffs did not seek damages resulting from an environmental harm
    • ELEA may provide a cumulative remedy if the NDIC fails or refuses to act
  • The comprehensive statutory framework preempted the common law conversion and waste claims

» **The Appeal:**
  • June 2014, plaintiffs in each of the 13 dismissed federal court cases filed Notices of Appeal with the Eighth Circuit
  • August 2014, plaintiffs dismissed their appeals before the briefing commenced
II. NORTH DAKOTA CLASS ACTIONS

» Consequences of the Litigation:

• Affirmed the role and the broad, primary jurisdiction and authority of the NDIC to regulate and address oil and gas issues

• Affirmed the principle that comprehensive regulatory schemes preempt common law claims in North Dakota

• Royalty claims under the North Dakota Flaring Statute presently cannot proceed on a class-wide basis
  • Plaintiffs’ May 23, 2014 letter to NDIC
  • NDIC’s June 3, 2014 response
II. NORTH DAKOTA CLASS ACTIONS

» A side note: Defining away uncommon issues?

Awareness builds & action becomes imminent
NDIC identified three goals:

• reduce the volume of natural gas flared;
• reduce the number of wells flaring; and
• reduce the duration of flaring from wells.

September 2013: Members of the NDPC create a Flaring Task Force

January 2014: NDPC Flaring Task Force presented its recommendation to the NDIC
NDPC Flaring Task Force recommendations

- Proposed a series of gas capture goals:
  - 74% of the gas by fourth quarter 2014;
  - 77% by first quarter 2015;
  - 85% by first quarter 2016; and
  - 90% by 2020 with potential for 95% capture
- "Gas Capture Plan" (GCP) requirement
  - Proposed potential penalties for non-compliance, such as denial of a drilling permit and curtailing production
- Several others involving all stakeholders
III. NORTH DAKOTA REGULATORY PROCEEDINGS

» Regulators’ response

- March 2014: NDIC prepared its assessment of the proposal and announced certain action items
- April 2014: NDIC hearing concerning amendments to field rules and received input from virtually all stakeholders
- May 2014: NDIC set forth required content of GCPs (amended in September 2014)
- July 2014: NDIC issued Order No. 24665
» NDIC’s flaring targets

• **By October 1, 2014**, capture 74% of the gas (flaring up to 26%)

• **By January 1, 2015**, capture 77% of the gas (flaring up to 23%)

• **By January 1, 2016**, capture 85% of the gas (flaring up to 15%)

• **By October 1, 2020**, capture 90% of the gas with the potential capture of 95% (flaring between 5-10% of the gas)
III. NORTH DAKOTA REGULATORY PROCEEDINGS

» Measuring Compliance with Gas Capture (Flaring) Targets:

- The gas capture percentage is calculated by “summing monthly gas sold plus monthly gas used on the lease plus monthly gas processed in a [NDIC] approved beneficial manner, divided by the total monthly volume of associated gas produced by the operator.” (NDIC Order No. 24665, Case No. 22058)

- “The Commission will accept compliance with the gas capture goals by well, field, county, or statewide by operator.” (NDIC Order No. 24665, Case No. 22058)

- However, failure to meet the gas capture goals can result in curtailment. “If such gas capture percentage is not attained at maximum efficient rate, the well(s) shall be restricted to 200 barrels of oil per day if at least 60% of the monthly volume of associated gas produced from the well is captured, otherwise oil production from such wells shall not exceed 100 barrels of oil per day.” (NDIC Order No. 24665, Case No. 22058)
III. NORTH DAKOTA REGULATORY PROCEEDINGS

» Measuring Compliance with Gas Capture (Flaring) Targets:

• The operator “may remove the initial 14 days of flowback” from the calculation. (NDIC Order No. 24665, Case No. 22058)

• “All wells completed in the [Bakken] that have received an exemption under N.D.C.C. § 38-08-06.4 shall be allowed to produce at a maximum efficient rate.” (NDIC Order No. 24665, Case No. 22058)

• Additionally, “the first horizontal well completed in a [Bakken] pool non-overlapping spacing unit shall be allowed to produce at a maximum efficient rate.” (NDIC Order No. 24665, Case No. 22058)
The NDIC recognizes the following means of using surplus gas as use in an approved beneficial manner:

1. wells equipped with an electrical generator that consumes surplus gas;

2. wells equipped with a system that takes in the surplus gas and natural gas liquids by means of compression to liquid for use as fuel, transport to a processing facility, production of petrochemicals or fertilizer, conversion to liquid fuels, separating and collecting the propane and heavier hydrocarbons; and

3. wells equipped with other value-added processes as approved by the Director that reduce the flare volume or intensity by more than 60 percent

(NDIC Order No. 24665, Case No. 22058)
III. NORTH DAKOTA REGULATORY PROCEEDINGS

Gas Capture Plans (GCP)

1. A statement made by a company representative indicating:
   a. The name of the gas gatherer(s) the company met with,
   b. That the company supplied the gas gatherer(s) with the following information:
      1. Anticipated completion date of well(s),
      2. Anticipated production rates of well(s)

2. A detailed gas gathering pipeline system location map which depicts the following information:
   a. Name and location of the destination processing plant,
   b. Name of gas gatherer and location of lines for each gas gatherer in the map vicinity,
   c. The existing gas line proposed to connect the subject well.

3. Information on the existing line, to which operator proposes to connect, including:
   a. Maximum current daily capacity of the existing gas line,
   b. Current throughput of the existing gas line,
   c. Gas gatherer issues or expansion plans for the area (if known).

(NDIC Sept. 16, 2014, revised letter to hearing applicants re: Gas Capture Plan Required Hearing Exhibit)
III. NORTH DAKOTA REGULATORY PROCEEDINGS

Gas Capture Plans (GCP)

4. A detailed flowback strategy including:
   a. Anticipated date of first production,
   b. Anticipated oil and gas rates and duration. If well is on a multi-well pad, include total for all wells being completed.

5. Amount of gas applicant is currently flaring:
   a. Statewide percentage of gas flared (total gas flared/total gas produced) for existing wells producing from the Bakken petroleum system. Note the Commission’s approved gas capture goals are to reduce flaring to 26% by October 1, 2014; 23% by January 1, 2015; 15% by January 1, 2016; and 10% by October 1, 2020.
   b. Fieldwide percentage of gas flared.

6. Alternatives to flaring:
   a. Explain specific alternate systems available for consideration,
   b. Detail expected flaring reductions if such plans are implemented.

(NDIC Sept. 16, 2014, revised letter to hearing applicants re: Gas Capture Plan Required Hearing Exhibit)
Operators are submitting acceptable GCPs

Industry exceeded the first gas capture target

- achieved 75 % (25 % flared) in October 2014, which exceeded the 74 % gas capture (26% flared) goal
- 60 of the 68 companies drilling in North Dakota exceeded the gas capture target

Questions remain concerning the proper calculation of compliance with the gas capture targets in particular circumstances
While it may not work in every situation, the experience in North Dakota serves as a good template for the all stakeholders to keep in mind. In the midst of lawsuits and regulatory and political pressures, industry participants (despite being fierce competitors) came together to consider the interests of all stakeholders and derived meaningful, yet obtainable goals. The regulators listened to all stakeholders (not just the industry task force) and provided a forum for them to provide meaningful input in the process. The result of the process likely is not perfect from any individual stakeholder’s perspective, but it embodies meaningful progress towards a common goal.
IV. REMAINING CHALLENGES

» Flaring on the Fort Berthold Reservation
  • Higher than off-reservation
  • From 2010 to 2012 → 45 % to 46 %

IV. REMAINING CHALLENGES

» Unique challenges on the Reservation
  • Additional difficulty obtaining rights-of-way
  • Competing jurisdictions: federal, state, and the Three Affiliated Tribes
    • The need to have approvals from multiple federal agencies (e.g., the BLM, the BIA, and the USFWS)
  • Certain tribal policies (e.g., lengthy ROW application, and long setback requirements for all pipelines and compressors, etc.)
  • The unique topography of the land, including Lake Sakakawea
  • Limited takeaway capacity
IV. REMAINING CHALLENGES

February 2014: a class of enrolled and non-enrolled members of the Three Affiliated Tribes initiated a putative class action lawsuit in the Three Affiliated Tribes District Court of the Fort Berthold Indian Reservation.

Surprisingly, despite the obstacles, the industry has been able to significantly reduce the percentage of gas flared on the Reservation.

Last month, the NDIC reported that the gas capture percentage for October on the Reservation was 74% (only 26% flared).

This was just one percentage point different than off-reservation gas capture (75%) and flaring (25%).

IV. REMAINING CHALLENGES

**Average Crude Oil Prices Per Barrel**
(average of three spot prices – Dated Brent, West Texas Intermediate, and the Dubai Fateh)

Falling oil prices in North Dakota

- July 2008: $136.29/barrel
- October 2014: $68.94/barrel
- January 14, 2015: $29.25/barrel

Source: [http://www.indexmundi.com/commodities/?commodity=crude-oil&months=180](http://www.indexmundi.com/commodities/?commodity=crude-oil&months=180)
IV. REMAINING CHALLENGES

» Effect of recently falling oil prices
  • Companies announced decreased spending
  • Decline in the drilling activity
    • October 2014, the rig count was 191
    • By mid-January 2015, the rig count was 156
Tax reductions: More activity despite falling prices?

• Oil extraction tax: 6.5% the gross value at the well of oil extracted

  • **Small trigger** – If the West Texas Intermediate (WTI) posted price falls below an average of $57.50 for one month, then the 6.5 percent tax is reduced to 2 percent on the first 75,000 barrels of production or for 18 months, whichever occurs first, for any well completed after the incentive is triggered. (N.D.C.C. § 57-51.1-03(9))
    – The small tax trigger officially began on Feb. 1, 2015

  • **Large trigger** – If the WTI posted price falls below $55.09 for five consecutive months, then there is a full exemption from the 6.5 percent oil extraction tax for all wells for the first 24 months of production. (N.D.C.C. § 57-51.1-03(3))

• 5% gross production tax still applies (N.D.C.C. § 57-51-02)
Political and other challenges

- January 2015: HB 1187 bill was introduced, which would void any rules enacted by the NDIC that did not undergo the administrative rulemaking process
  - This would include the recent flaring standards
- January 2015: SB 2251 was introduced, which would amend and reenact N.D.C.C. § 38-08-1687
  - The bill mandates that civil penalties for violating rules or orders concerning the conservation of oil and gas would be no less than the cost of enforcement and remedying the violation.
  - The commission would be permitted to reduce or repeal the fine only after the full amount of the fine has been paid and the violation is found to have been beyond the control of the violator.
- January 2015: SB 2287 was introduced, which would amend N.D.C.C. § 38-08-06.4 to reduce the initial period of flaring allowed after first production to 90 days
  - It also prohibits exemptions unless the volumes of flared gas are less than or equal to 50,000 cubic feet per day.
  - A similar bill, SB 2343, would do the same as SB 2287, but reduce the period of initial flaring even further to 14 days
- Federal legislation too
  - Obama Administration announced initiatives
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